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Crisis: A Terrible Thing to Waste

Connecticut's Budget Dilemma and the Opportunity for Reform

By Representative Tom Reynolds (D-42nd), Connecticut General Assembly

[Editor's Note: The following excerpts come from Representative Tom Reynolds' whitepaper, "Crisis: A Terrible Thing to Waste." Reynolds brought his eye-opening presentation to the CSCPA's "Friday Focus for Members in Industry" on March 19, 2010 and has been involved in the Society's "Fixing Our Future" legislative efforts.]

Introduction

Connecticut is facing its greatest fiscal crisis since 1991. The national economy has had a dramatic impact on state budget revenues, thus driving the state into major deficits. We are paralyzed by many of the public policy challenges before us. Combined with the emergence of daunting demographic realities and unchecked growth in major programs, Connecticut is in the midst of a "perfect storm" that could be crippling in historic proportions.

However, our current fiscal state and our limited capacity to address it are, in many ways, self-imposed. This paper will reveal a history of policies and practices and a reluctance to make tough decisions that have exacerbated and contributed to our fiscal crisis. Our own actions – and inaction – have made us more vulnerable to the national recession, fueled the pace of our economic decline, and ensured that we will emerge from it long after the rest of the nation.

But this dilemma presents an opportunity to pursue a blueprint for change that, if pursued, will help the state endure and emerge more quickly from future economic downturns and embolden us with the resources and disciplined systems necessary to address our greatest public policy challenges.

Most importantly, this blueprint argues that our future is a story for which we must be the authors. Our future is now written for us as we react to crises and external forces, while lurching from budget to budget and election to election. This crisis is an opportunity to set our state on a course of our own choosing. This crisis is a chance for leaders – in both parties and from both the executive and legislative branches – to exert courageous and visionary leadership to fundamentally change the way state government works.

After all, a crisis is a terrible thing to waste.

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Background

The FY 2009 budget had a projected deficit of nearly $1.4 billion. The FY 2010 budget had a projected deficit of $4 billion (21.4 percent of the budget), and the FY 2011 budget deficit is estimated at $4.7 billion (24.2 percent). Together, this results in a projected deficit of $8.7 billion for the next biennium.[1]

The sheer size of the FY 2010-FY 2011 deficit is unprecedented in total dollars, although the combined FY 1991 and 1992 deficits that led to the income tax were larger as a percentage of the total budget.[2]

During the annual budget accountability report presented by the Office of Fiscal Analysis in November 2008, the legislature learned that revenue declines – much of which can be attributed to the national recession – accounted for just over one-half of the projected FY 2010 deficit.

The remaining one-half of the deficit was the result of increased spending on new and existing programs and structural holes created by using one-time revenues, such as surpluses, for ongoing expenses.[3]

In other words, our own decisions over many years – and not just the national recession – are responsible in a significant way for our current and projected deficits. Therefore, waiting out the recession will not be enough.

The most significant driver in the FY 2010 deficit was declining revenues. Historically, the state budget enjoyed average revenue growth of 3.8 percent per year ($620 million). The revenue forecast for FY 2010 was -8.6 percent, a decline of $1.4 billion – a total one-year drop of *$2 billion*.[4]

Increased spending in four major areas was also a major driver in the FY 2010 deficit, accounting for a total of $945 million, or 25 percent of the deficit.

[1] Office of Fiscal Analysis, Connecticut General Assembly
[2] Office of Fiscal Analysis, Connecticut General Assembly
[3] Office of Fiscal Analysis, Connecticut General Assembly
[4] Office of Fiscal Analysis, Connecticut General Assembly

Connecticut's ability to create jobs has only eroded over time.

These four areas of growth occurring between FY 2009 and FY 2010 are:

1. State employee wages and benefits: increase of $453 million
2. Medicaid: increase of $245 million
3. Debt service: increase of $163 million
4. Local education grants: increase of $84 million[5]

Connecticut's ability to create jobs has only eroded over time. Business growth has been flat, while it increased nationally and in the northeast. The job growth we have enjoyed has occurred disproportionately in low-paying industries.[6]

Between 2000 and 2030 in Connecticut, the state's population is expected to grow only eight percent, while the nation will grow by nearly one-third. The elderly, intense users of health and human services, will increase by nearly 70 percent. The population between age 18 and 64 – those who will pay for these increased services – will shrink. The school age population will remain flat or decline.[7]

The state's lack of success on the economic development front does not bode well for the immediate future. In the last recession Connecticut lost jobs sooner and took much longer to recover them than the rest of the nation. Connecticut lacks a long-term, innovative, and visionary economic development strategy.

Most Connecticut families are worse off now than at the start of the last recession. Connecticut was the only state in which real income of the poorest 20 percent of families *fell* since the late 1980s. Our middle income families had the second smallest gain in average income in the same period. However, our wealthiest 20 percent experienced a 45-percent increase in average real income, the second highest increase in the country.[8]

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5 Office of Fiscal Analysis, Connecticut General Assembly
6 *Connecticut 2020*, Connecticut Economic Resource Center, November 2008
7 *2008 Fiscal Accountability Report*, Connecticut Office of Policy and Management
8 *Follow the Money*, Connecticut Voices for Children

The economic success of our wealthy residents is not to be criticized. After all, many of our citizens aspire to such success and much of our income tax revenue (including capital gains) comes from these households. However, we need a strategic economic development plan that will ensure opportunity for the vast majority of our citizens who are not wealthy.

The national recession and resulting deficits, combined with these demographic and economic trends and exacerbated by the policies and practices to be outlined below, make for a "perfect storm." This dilemma presents a unique opportunity to change business as usual.

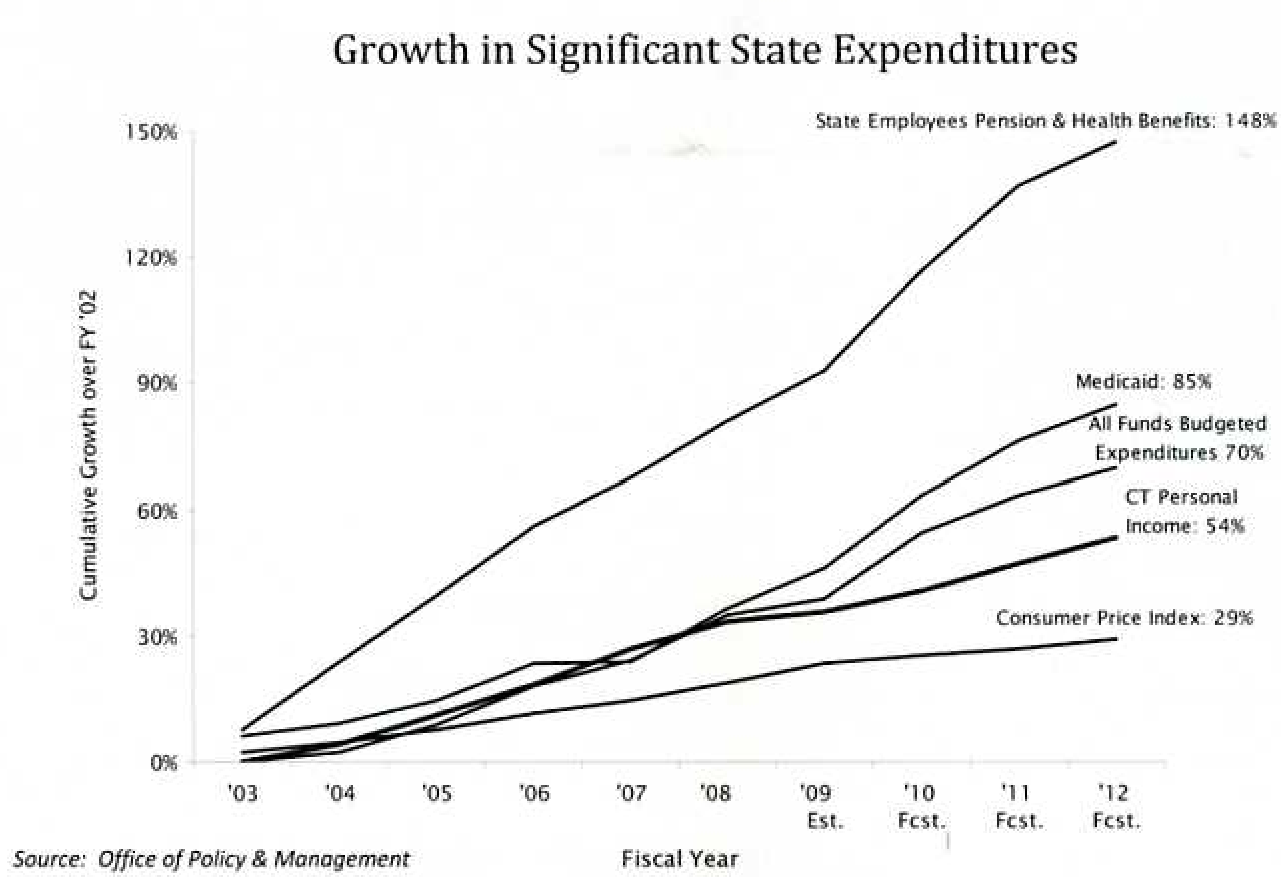
Agenda for Reform

We can dramatically alter our budget practices and policies. We can permanently change the dynamic between state and local government. We can enact historic and comprehensive budget and tax reform. We can enhance the legislature's oversight role in a number of areas. If we act boldly, we will address our greatest public policy challenges and successfully endure future recessions.

What is Connecticut doing – or failing to do – that has handicapped our capacity to address long-festering public policy issues? What current policies and practices have exacerbated the budget crisis?

How can Connecticut fundamentally change the way state government works and embark on a new era of reform?

This crisis is a chance for leaders – in both parties and from both the executive and legislative branches – to exert courageous and visionary leadership to fundamentally change the way state government works.



Source: Office of Policy & Management

The agenda for reform reviews the origins of our budget dilemma and makes recommendations for addressing them in the coming decade.

The reform agenda proposes changes in 10 major areas:

1. Long-term planning
2. Performance and accountability
3. Spending
4. Spending cap
5. Tax policy
6. Tax expenditures
7. Unfunded liabilities
8. Indebtedness
9. Budget reserve fund
10. Accounting methods

Some elements of this reform plan have been discussed for years. State Comptroller Nancy Wyman, State Treasurer Denise Nappier, and selected legislators from both parties have been sounding the alarm about many of these worrisome trends and the need for reform.

Now is the time to seize the momentum created by the crisis and these forward-thinking leaders and combine these varied strategies into a comprehensive reform agenda that will force a historic shift in the way state government works in Connecticut.

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The Crisis by the Numbers

Spending

Between FY 2003 and FY 2012, when the Consumer Price Index is projected to increase 29 percent, total state spending is projected to grow by 70 percent. Expenditures on state employee pension and health benefits are projected to increase nearly 150 percent – more than double that of the overall budget.[21]

Medicaid, which provides critical healthcare programs to the elderly and poor, is projected to increase 85 percent. Medicaid is one of the largest line items in the state budget at $3.7 billion for FY 2009.[22] State healthcare costs for all programs increase by at least 10 percent per year with no plan to slow the growth.[23] State agency energy costs have risen 135 percent from FY 2000 to FY 2008, with no comprehensive energy plan underway.[24]

Spending Cap

A spending cap can be good public policy, and it has slowed the growth of state spending in many areas. However, Connecticut's cap is poorly designed and increasingly unworkable. As a result, it is routinely ignored. For example, Governors Rowland and Rell issued "emergency" declarations, supported by the legislature, to exceed the cap in eight of the last 11 fiscal years for a total of $3.6 billion of spending above the cap.

What's more, the spending cap's flaws have resulted in additional "spending" through budget techniques that circumvent statutory restrictions, while giving the appearance of a "cap" on spending – leading to greater taxpayer obligations over the long run.

For example, the cap has increased our dependence on borrowing for small projects and ongoing expenses, since debt service payments are exempt from the cap – costing taxpayers much more in the long run. Total debt service as a percentage of the state budget has nearly doubled in the last two decades, from 5.3 percent of state spending in FY 1988 to 10.4 percent in FY 2008.[25]

Revenue Sources

The top five revenue sources in FY 2009, accounting for nearly 90 percent of total revenue, were:

1. Personal income tax – $6.7 billion
2. Sales and use tax – $3.4 billion
3. Federal grants – $3.1 billion
4. Business taxes – $1.1 billion
5. Gaming revenue – $677 million[28]

Local Property Taxes

In Connecticut the local property tax collects more revenue than any other tax – local or state. When accounting for all local and state tax revenue, the property tax accounts for $7.8 billion (39 percent), income tax for $6.4 billion (32 percent), and sales tax for $3.5 billion (18 percent).[30]

Connecticut ranks second – at 31 percent – among all states in the share of its state and local own source general revenues that come from the property tax.[31] This results in an unfair burden on low- and middle-income families and on businesses and incentivizes towns to make poor economic development decisions.

21 *2008 Fiscal Accountability Report*, Office of Policy and Management
22 Office of Policy and Management, State of Connecticut
23 *Transforming Government*, David Osborne, The Public Strategies Group
24 Connecticut Office of Policy and Management
25 *State Spending Cap Needs Some Repair*, Connecticut Voices for Children
28 Office of Fiscal Analysis, Connecticut General Assembly
30 Office of Fiscal Analysis, Connecticut General Assembly
31 *Follow the Money*, Connecticut Voices for Children

Unfunded Liabilities

Unfunded liabilities represent what the state is obligated to pay in the future in the form of pensions, health insurance, and other benefits for teachers and state employees. Connecticut's unfunded state pension liabilities for teachers and state employees are nearly $16 billion. Compared to all other states, we are dead last at funding only 56 percent of this obligation.[36]

Our unfunded liability for "other post-employment benefits" (OPEB), like health and life insurance for teacher and state employee retirees, is $24 billion. Again, we rank dead last among all states by funding almost nothing towards this obligation.[37] Together this is a total unfunded liability for pensions and other retiree benefits of $40 billion – more than our entire biennial state budget.

Indebtedness

Connecticut's bonded indebtedness now totals $17 billion – ranking Connecticut third highest among all states in per capita state debt. Debt service is now one of the largest line items in the state budget after only state employee wages and benefits, Medicaid, and local education grants.

In 1988, 5.3 percent of state spending was spent on debt service. By 2007 it had more than doubled to 11.4 percent.[39] In FY 2007 Connecticut spent $1.8 billion on debt service. In 2010, debt service could approach $2.2 billion per year, or more than 12 percent of the budget.[40]

Budget Reserve Fund

State law allows the Budget Reserve Fund (BRF) to equal up to 10 percent of net general fund appropriations. The Rainy Day Fund now has a balance of nearly $1.4 billion, which is 81 percent of the full statutory capacity or $330 million short.[42] The state's failure to meet this statutory threshold is largely the result of using surpluses in good years to fund ongoing programs, rather than for building the Rainy Day Fund.

Between FY 2004 and FY 2008 the state enjoyed cumulative surpluses of $3.7 billion. However, only one-third of it was deposited into the Rainy Day Fund and only eight percent to reduce debt. More than half of it was used for future program expenditures and other purposes.[44]

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To read this whitepaper in its entirety, visit
www.housedems.ct.gov/reynolds/pubs/Reynolds_Budget_Paper_April_17.pdf.

[36] *Beware Those Sleeper Taxes*, The Connecticut Economy
[37] *Beware Those Sleeper Taxes*, The Connecticut Economy
[39] Office of Fiscal Analysis, Connecticut General Assembly
[40] *Coping with the Cap*, Connecticut Voices for Children
[42] *2008 Fiscal Forecast*, Office of Fiscal Analysis
[44] *2008 Fiscal Accountability Report*, Connecticut Office of Policy and Management